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Mr. Honesto Gatchalian
Energy Division
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: PG&E's Comments on Draft Resolution E-4160

Dear Mr. Gatchalian:

Pacific Gas and Electric Company (PG&E) submits the following comments on Draft Resolution E-4160 (Draft Resolution), which was circulated on March 12, 2008 in accordance with public review and comment requirements prior to the Commission's consideration and potential vote on April 10, 2008.

Summary of PG&E's Position

PG&E is one of the most active participants in the California renewable energy market and is deeply concerned that the rules for administration of the Above-MPR Funds (AMF) proposed by the Draft Resolution have the potential to discourage renewable portfolio standard (RPS) transactions. In its current form, the Draft Resolution's basis for counting a power purchase agreement (PPA) toward the AMF, a potentially protracted review process, and stricter standard for a finding that a PPA is reasonable and eligible for rate recovery are problematic, while its ratemaking terms are adequate. PG&E sought to shed light on the AMF proposal by participating in the *Joint Party Request For Bifurcation Of Issues Addressed In Draft Resolution E-4160* submitted to the Executive Director on March 28, 2008 by Southern California Edison Company (SCE). PG&E appreciates the March 28 letter ruling of the Executive Director granting bifurcation and establishing a workshop on May 7, 2008.

In these comments, PG&E addresses both of the key issues presented by the Draft Resolution. First, PG&E recommends the Commission relieve the IOUs from continuing to pay the California Energy Commission (CEC) funds to support a program that was cancelled effective January 1, 2008, by making its Resolution effective as of January 1, 2008. PG&E also comments on the AMF – related terms of the Draft Resolution as requested by the Executive Director.

Basis of Draft Resolution

The purpose of Draft Resolution E-4160 is to implement Senate Bill (SB) 1036 (Ch. 685, Stats. 2007), which discontinued the use of public good charge funds to pay the above-market costs of new renewable resources. These funds were collected in electric rates and paid by the IOUs to the CEC for disbursement to eligible generators in the form of "supplemental energy payments"(SEPs). SB 1036 directed the CEC to return unused SEP funds to the IOUs for the benefit of customers, as determined by the CPUC. SB 1036 also created a virtual fund equal to the pre-existing SEP fund plus what would have been collected in rates to fund SEPs during the authorized term of the public good charge. The above market-price cost of eligible procurement will be debited against the virtual fund until the fund is exhausted. SB 1036 retains the SEP cap adopted in SB1078 by capping the cost of each IOUs' obligation to procure renewable energy using specified commercial vehicles at market price plus the value of the virtual fund. [1] The virtual fund, also known as the "Above Market Price Referent (MPR) Funds" (AMF) in the Draft Resolution, is an allowance administered by the Commission. Actual cash from customer receipts are not set aside for the AMF; the AMF is only an allowance administered by the Commission. Both the AMF and other above-market RPS procurement costs are paid out of general electric procurement rates.

I. RATEMAKING ISSUE – REMITTANCE OF FUNDS TO THE CEC

PG&E was required by Resolution E-3792 to collect a "public good charge" in rates from January 1, 2002 through January 1, 2012 to fund renewable energy and to remit an annually-calculated amount to the CEC. SB 1036 reduces the public good charge requirement by $37,022,636 to eliminate the SEP portion of the CEC payment as of January 1, 2008.

The utilities' next quarterly payment to the CEC was due on March 31, 2008. However, Resolution E-4160 will not be finalized until April 10, 2008. In order to avoid over-remitting funds to the CEC which would then need to be refunded back to the utilities; CEC staff and PG&E agreed that PG&E should reduce its March 31st remittance to reflect the Interim 2008 Authorized Renewable Funding as stated in the Draft Resolution.

Additionally, PG&E is required under E-3792 to file an Advice Letter by March 31st to reflect annual adjustments to the public good charge obligation. Consistent with the

[1] Specifically, SB 1036 directs the Commission to establish a limitation on the total costs expended above the market price referent (MPR) for the procurement of eligible renewable energy resources to achieve RPS annual procurement targets. The cost limitation is equal to "the amount of funds transferred to each electrical corporation by the CEC … and the 51.5 percent of the funds which would have been collected through January 1, 2012, from the customers of the utility based on the renewable energy public goods charge in effect as of January 1, 2007" (Public Utilities (Pub. Util) Code section 399.15(d)).

Draft Resolution and the agreement between CEC staff and PG&E, PG&E used the Interim 2008 Authorized Renewable Funding as stated in the Draft Resolution as the new basis apply the annual adjustment for purposes of determining the 2008 public good charge funding obligation.

Because no purpose would be served by continuing to remit SEP payments to the CEC or to book SEP payments into PG&E's Public Purpose Program Revenue Adjustment Mechanism (PPPRAM), Resolution E-4160 should be made effective as of January 1, 2008.[2] This is consistent with the intent of SB 1036 and the agreement reached between CEC staff and PG&E on the March 31st remittances. The text on page 9 of the Draft Resolution immediately following Table 5 and continuing on page 10, should be modified to be consistent with the foregoing discussion.

II. ABOVE-MPR FUND ELIGIBILITY

The Draft Resolution significantly modifies the process for Commission approval of PPAs priced above the MPR by proposing another level of review to determine whether a PPA would be eligible for an allocation of AMF and has the potential to interfere with the procurement of renewable energy resources. PG&E suggests that the May 7th workshop address at least the following issues, as well as other issues of concern to interested parties.

A. The Resolution Should Make Technical Corrections to Ensure that RPS Contract "Cost" Supported by the AMF Is Expressed in Financial Terms Consistent with the AMF's Funding Source.

Methodological Criteria Used in the AMF Calculator.

Draft Resolution section 3.2.1 adopts an RPS cost limitation for each IOU, and section 3.2.2 provides an AMF Calculator for each IOU to keep track of funds applied toward the cost limitation. The Calculator computes the stream of above-MPR payments under a specific PPA and then discounts it by the IOU's Weighted Average Cost of Capital (WACC) to derive the above MPR "cost" to be supported by the AMF. The result of this calculation understates the amount of AMF that should be allocated to an individual contract. PG&E proposes that it would be more appropriate to "deflate" the above MPR contract costs, rather than "discount" those amounts.

Calculating the above-MPR cost as the sum of above-MPR payments discounted to 2008 values[3] using the WACC assumes that during the term of the PPA there is a "virtual fund" earning at the WACC rate. The AMF is not a real fund but an account (or "virtual fund"), and there is actually no invested principal on which to earn at the WACC rate.

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[2] *See* Pub. Util. Code Section 1731(a) ("The commission shall set an effective date when issuing an order or decision. The commission may set the effective date of an order or decision prior to the date of issuance of the order or decision.")

[3] "AMFs requests will be calculated as the NPV of above-MPR contract costs, in 2008$." Draft Resolution fn 55.

The above market MPR amounts cannot be paid from a virtual fund, but will be paid in nominal dollars by customers paying the public good charge.

The AMF accrues funds in accordance with the schedule for the collection of PGC funds through the Public Purpose Program surcharge which is set at the rate of growth in the sales forecast or the GDP deflator, whichever is lower. Escalation at the WACC is contrary to how the Commission has escalated Public Goods Charge monies previously. The use of the WACC to discount future AMF payments would require customers to pay out nominal dollars that will be much greater than the virtual fund that is funded by the Public Good Charge and establishes the cost limitation.

To avoid this unintentional cost to consumers, the AMF Calculator should be revised to calculate the cost of each above-MPR contract based on actual payments, adjusted by the GDP deflator.

Consistency with CEP SEP spreadsheets

The input values for the AMF Calculator should be modified since they are inconsistent with the former "CEC SEP" spreadsheet. Actual payments for each TOD period are listed as inputs in the AMF calculator tab "INPUT CONTRACT DATA." These TOD specific prices do not exist as input since developers bid in a single price per MWh and the IOU apply TOD factors to that bid price in order to calculate the value of the bid based on the expected generation schedule. Moreover, the "MPR for Contract Start Year ($/MWh)" in tab "AMFs CALCULATION" should be the TOD adjusted MPR (i.e., the value calculated in Cell F38 of the tab "TOD ADJUSTED MPR"), rather than the flat input energy cost.

B. The Bias Toward Disqualifying PPAs from Counting Against the AMF Undermines the Economic Protection of SB 1036 and is Potentially Unlawful.

The Draft Resolution disqualifies entire categories of PPAs from counting toward the AMF as part of a strategy to "save" limited AMF credits for contracts that meet the Draft Resolution's viability criteria. The result of these policies is to maintain AMF fund availability so that IOUs must continue to procure RPS eligible power, even though substantial, uncapped procurement expenses have been incurred. Yet, SB 1036 placed no restrictions on the eligibility of renegotiated contracts, out of state generation, or deliveries using banking and shaping. The Draft Resolution does not explain why RPS-eligible resources, such as generation from out-of-state facilities, or generation that is delivered using CEC-approved banking and shaping strategies, should not count toward an IOU's RPS procurement expense cap. This issue must be explored in the workshop.

In addition to disqualifying categories of PPAs, the Draft Resolution appeared initially to establish a higher standard of reasonableness for PPAs eligible for AMF. Subsequently, the Draft Resolution applied the same reasonableness review criteria to contracts priced above the MPR, regardless of AMF eligibility. However, since the reasonableness criteria were not clearly applied to PPAs reached through bilateral negotiation versus

competitive solicitation, the symmetrical application of any changed reasonableness standard must be confirmed. The Draft Resolution may also be construed to apply the stricter standard to all RPS contracts that have not yet received CPUC approval.[4] Applying more stringent standards to RPS contracts may have unintended consequences. Finally, the Commission should also clarify the relationship between the reasonableness standards presented in this resolution with the reasonableness standards being addressed for bilateral contracts in R. 06-02-012.

The following examples illustrate how the Draft Resolution fails to limit RPS expenditures as required by SB 1036:

1. If a Commission-approved PPA is subject to renegotiation, it will be considered to be a "bilateral contract" if the staff considers it to be "substantially different from the original contract.[5] Bilateral contracts do not count against the procurement cap. The reason for excluding a renegotiated contract from the cap is not clear, although the Draft Resolution resolved that limited AMF funds should support projects with a high likelihood of success.[6] Recently renegotiated contracts incorporate terms that will enable development to proceed; whether the renegotiated contract is "substantially different" or not is immaterial to the AMF funding purpose expressed in the Draft Resolution. There is no reason to disqualify a renegotiated PPA from counting against the AMF cap.

2. At the Commission's discretion, a partial AMF allocation may be approved for an RPS contract either because the cost limitation does not cover all contract costs or because the Commission deems it reasonable to approve only part of the contract costs toward the cost limitation.[7] Under these circumstances, it is not clear how the remainder of the contract costs will be paid to the seller – are the remaining costs deemed to be unreasonable, in which case the PPA is not approved? Are the remaining costs to be recovered in non-AMF rates, in which case the partial allocation of AMF fails to protect consumers against RPS procurement costs?

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[4] "(Projects ineligible for AMFs and/or if the IOU's cost limitation has been reached) will be reviewed using the same AMFs reasonableness review criteria listed above (Section 3.3) in addition to the standard evaluation methodology for advice letters requresting approval for renewable PPAs." Draft Resolution Section 3.4. Since all PPAs are either eligible or ineligible for AMFs, the Draft Decision appears to impose the higher reasonableness review standard upon all PPAs that have not yet been approved by the CPUC.

[5] Draft Resolution Section 3.2.3 par 2). Bilateral contracts are ineligible for AMF, see, Pub. Util. Code Section 399.15

[6] "These reasonableness review standards are set forth to promote the efficient use of limited above-market funds, in a manner than maximizes ratepayer benefit." Draft Resolution Section 3.3.2, p. 20 above "Tier 1".

[7] Draft Resolution Section 3.3.2.

3. The effectiveness of each RPS PPA is contingent upon the receipt of "CPUC Approval". The Draft Resolution requires a PPA priced above the MPR to pass an additional reasonableness review before AMF are allocated to the PPA. If a PPA does not pass the AMF reasonableness threshold, could the Commission still find the PPA to be reasonable and grant "CPUC Approval", so that the IOU is required to perform even though the PPA expense does not count against the AMF cap?

C. The proposed "reasonableness review" of AMF requests will discourage developers from participating in California's RPS marketplace.

Draft Resolution E-4160 requires AMF-eligible RPS projects seeking Commission approval to undergo a reasonableness review process in addition to the review of the PPA. The reasonableness review standards are very similar to reasonableness review criteria used to evaluate the progress of PPAs that have already been approved and are under development. However, in PG&E's experience, few of these development milestones can be established in advance of CPUC PPA approval, because lenders will not commit funds necessary for development until major regulatory approvals have been obtained. Based on its procurement experience, PG&E believes that no developer is able to bear the burden of showing that its development is as "reasonable" as required by the draft resolution and that few would agree to the level of scrutiny applied to IOUs, e.g., providing an Independent Evaluator with a proposed project's financial model. [8]

The Draft Resolution seeks broad categories of information while providing no indication of how the information will be analyzed. Of most concern, the draft resolution specifies that PPA review will include a review of the project financial model. Review of developer finances and projected rate of return is fundamentally inconsistent with an unregulated, competitive market. If the developer cannot make the required showing, or if it appears that the developer is making "too much" profit it appears that the negotiated PPA will not be approved. This may have a significant, detrimental impact on renewable energy development. Overall, the cumbersome regulatory process proposed by the Draft Resolution will most likely prolong the regulatory review process and may convince a developer to forego development in California in favor of other opportunities.

[8] The requirement of 100% site control, for example, may be impossible for all but a few developers to meet; the larger and more substantial the development, the less likely that "all estimated project development milestone dates relevant to interconnection studies, financing, site control, and equipment procurement" can be established.

III. SUGGESTED FINDING, CONCLUSION, AND ORDERING PARAGRAPHS.

A. Proposed Finding of Fact 12a

The funds to be collected and remitted to the CEC by the utilities under Resolution E- 3792 exceed the corresponding amounts required by SB 1036. This resolution will supersede Resolution E-3792 and direct the utilities to remit only the funds required by SB 1036. The first quarter remittances to the CEC were due no later than March 31, 2008. In order to avoid the need for future refunds from the CEC to the utilities, this resolution is made retroactive to January 1, 2008 consistent with SB 1036.

B. Proposed Conclusion of Law 7a

Resolution E-4160 should be retroactive to January 1, 2008, the effective date of legislation that changed the utilities' obligation to remit funds to the CEC, so that the utilities are directed to remit the correct amount of public good charge funds to the CEC beginning the first quarter of 2008.

C. Proposed Ordering Paragraph 1

~~This Resolution is effective today.~~

This Resolution is effective as of January 1, 2008.

IV. Conclusion

As noted above, these initial comments on the Draft Resolution provide broad, high-level comments on the Energy Division's AMF proposal. A full appreciation of the rules and their impact on California's RPS market should be possible through the May 7 workshop and follow up briefing.

PG&E appreciates your attention to these comments and looks forward to participating in the May 7 workshop to ensure that Draft Resolution E-4160 achieves the consumer protection provided by SB 1036 while enhancing RPS development opportunities in California.

Sincerely,

Vice President, Regulatory Relations

Cc:

President Michal R. Peevey
Commissioner John A. Bohn
Commissioner Timothy A. Simon
Commissioner Rachelle B. Chong
Commissioner Dian M. Grueneich
Paul Clanon, Executive Director, CPUC
Sean Gallagher, Director- Energy Division
Paul Douglas, Energy Division
Cheryl Lee, Energy Division
Service List for R.06-05-027
Service List for R.06-12-012

CERTIFICATE OF SERVICE

I certify that I have by mail, e-mail, or hand delivery this day served a true copy of Pacific Gas and Electric Company's comments on Draft Resolution E-4160, regarding PG&E's Advice Letter 3001-E, on 1) Honesto Gatchalian, 2) the entire service list for Draft Resolution E-4160, 3) all CPUC Commissioners, 4) Sean Gallagher, Director of Energy Division and 5) Cheryl Lee, Energy Division.

Dated April 1, 2008, at San Francisco, California.

____/s/_____
David Poster
PACIFIC GAS AND ELECTRIC COMPANY